

## First Read

# Aqua America Inc

## Line of Sight to Merger Close Not as Clear as Expected

### Two Intervenor Holdouts Take the Merger down a Litigated Path

During the hearing yesterday at the PA Public Utilities Commission for the merger between WTR and Peoples, it was disclosed that WTR reached a settlement with most intervenors in the case, with the exception of two parties to the docket: the Bureau of Investigation and Enforcement (BIE) and the Office of Small Business Advocate (OSBA). WTR filed an 8K today with little detail regarding the sticking points for the two intervenors; however, as we understand it, BIE (which is effectively the PUC Staff) disagrees with an aspect of the settlement reached with the other parties related to a small gas system (Goodwin Tombaugh ~1,600 customers) within Peoples. As a result of failing to reach an all-party settlement, the merger case will have to proceed through a litigated process to address the outstanding issues. Although at this stage we don't believe the issues put the transaction in jeopardy, this development is disappointing. We had anticipated that WTR would be successful in reaching settlement with all parties based on the confidence that management portrayed earlier in the process, as well as indications that transaction financing would only be issued when there was "line of sight" to merger close. In April, WTR issued \$900MM debt, \$650MM convertible equity units, and ~\$1.3B in common equity, in addition to another \$750MM that will be placed privately upon merger close.

### Peoples Rate Case

The Peoples rate case is proceeding on a parallel path at the PA commission. Settlement discussions are expected to begin ~early-July and WTR expects to be more active in Peoples' rate case once settlement discussions begin. Rate case proceedings in PA have a history of settlement. It remains unclear if/how the intervenor issues in the merger docket would weave into the rate case.

### Next Steps

Briefs in the merger docket are due July 10 and reply briefs are due July 25. WTR now expects the merger to close fall 2019, as opposed to its original projection for a close in mid-2019.

### Valuation: \$42 Price Target

We value WTR at a 25.2x P/E on 2021e EPS of \$1.68.

## Equities

Americas  
Water Utilities

**12-month rating** **Buy**
**12m price target** **US\$42.00**
**Price** **US\$41.12**
**RIC:** WTR.N **BBG:** WTR US

### Trading data and key metrics

**52-wk range** US\$41.12-32.37  
**Market cap.** US\$7.34bn  
**Shares o/s** 178m (COM)  
**Free float** 100%  
**Avg. daily volume ('000)** 461  
**Avg. daily value (m)** US\$17.4  
**Common s/h equity (12/19E)** US\$2.15bn  
**P/BV (12/19E)** 3.4x  
**Net debt / EBITDA (12/19E)** 5.1x

### EPS (UBS, diluted) (US\$)

	12/19E	
	UBS	Cons.
<b>Q1E</b>	0.30	0.28
<b>Q2E</b>	0.39	0.40
<b>Q3E</b>	0.47	0.41
<b>Q4E</b>	0.32	0.36
<b>12/19E</b>	1.48	1.46
<b>12/20E</b>	1.58	1.56
<b>12/21E</b>	1.68	1.66

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Highlights (US\$m)	12/16	12/17	12/18	12/19E	12/20E	12/21E	12/22E	12/23E
<b>Revenues</b>	820	810	838	881	921	956	995	1,033
<b>EBIT (UBS)</b>	326	329	337	370	399	425	454	482
<b>Net earnings (UBS)</b>	234	240	251	265	281	299	319	342
<b>EPS (UBS, diluted) (US\$)</b>	1.32	1.35	1.41	1.48	1.58	1.68	1.79	1.92
<b>DPS (US\$)</b>	0.74	0.79	0.88	0.94	1.00	1.07	1.15	1.23
<b>Net (debt) / cash</b>	(1,891)	(2,121)	(2,376)	(2,676)	(2,840)	(2,994)	(3,135)	(3,263)
Profitability/valuation	12/16	12/17	12/18	12/19E	12/20E	12/21E	12/22E	12/23E
<b>EBIT margin %</b>	39.7	40.6	40.3	42.0	43.3	44.5	45.6	46.7
<b>ROIC (EBIT) %</b>	9.0	8.4	7.9	8.0	8.0	8.1	8.3	8.4
<b>EV/EBITDA (core) x</b>	16.2	17.0	17.6	18.9	18.1	17.4	16.7	15.8
<b>P/E (UBS, diluted) x</b>	23.9	24.8	25.0	27.7	26.1	24.5	23.0	21.5
<b>Equity FCF (UBS) yield %</b>	0.2	(1.6)	(1.6)	(1.8)	0.2	0.5	0.9	1.2
<b>Net dividend yield %</b>	2.3	2.4	2.5	2.3	2.4	2.6	2.8	3.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US\$41.12 on 12 Jun 2019 18:43 EDT

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### Forecast returns

Forecast price appreciation	+2.1%
Forecast dividend yield	2.3%
Forecast stock return	+4.4%
Market return assumption	6.9%
Forecast excess return	-2.5%

### Valuation Method and Risk Statement

Risks include, but are not limited to: rising interest rate; regulatory and policy risks; operational risks; construction risks; water quality, safety and contamination risk; physical risk to the water sources, treatment or delivery systems; cybersecurity risk; drought and extreme weather events.

Our price target is premised upon a 1% discount to the 2021 average UBS water P/E multiple. The discount reflects the sum of: a 5% discount to reflect Water group over-valuation relative to the S&P 500, 5% premium to reflect high quality regulatory jurisdiction ranking, 6% premium to reflect operations in six Fair Market Value states, and 7% discount to reflect impact of lower P/E associated with gas earnings.

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Buy	FSR is > 6% above the MRA.	47%	25%
Neutral	FSR is between -6% and 6% of the MRA.	39%	22%
Sell	FSR is > 6% below the MRA.	14%	19%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2019.

1: Percentage of companies under coverage globally within the 12-month rating category.

2: Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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### Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>Aqua America Inc<sup>16</sup></b>	WTR.N	Buy	N/A	US\$41.12	12 Jun 2019

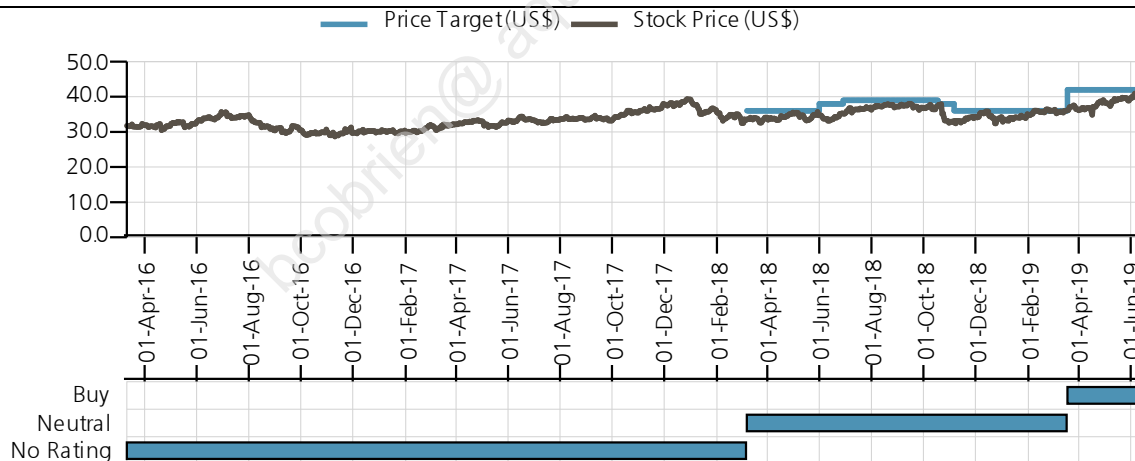
Source: UBS. All prices as of local market close.

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### Aqua America Inc (US\$)



Date	Stock Price (US\$)	Price Target (US\$)	Rating
2016-03-11	31.72	-	No Rating
2018-03-08	33.52	36.0	Neutral
2018-06-01	34.71	38.0	Neutral
2018-06-29	35.18	39.0	Neutral
2018-10-18	37.23	38.0	Neutral
2018-11-06	32.59	36.0	Neutral
2019-03-19	36.12	42.0	Buy

Source: UBS; as of 12 Jun 2019

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